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SUBJECT: TAIWAN,S HIGH-SPEED RAIL DELAYED ONE YEAR

REF: TAIPEI 490

Classified By: AIT Acting Director David J. Keegan, Reason 1.5 d

Summary

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1. (C) Taiwan High-Speed Rail Corporation (THSRC) announced September 8 that the inauguration of the high-speed rail will be delayed exactly one year to October 31, 2006. Reports indicated that delays in construction of the signal and communications components of the core electrical machinery (EM) systems were to blame. THSRC estimated the additional cost imposed by the delay to total NTD 19.3 billion (about USD 590 million), which will only exacerbate the firm,s continuing financial problems. Premier Frank Hsieh reiterated the government,s unwillingness to buy back the project as required if THSRC fails to complete construction, but the latest news suggests that a more active government role may be required. End summary.

THSRC Postpones Inauguration by One Year

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2. (U) THSRC Chairperson Nita Ing announced September 8 that the inauguration of Taiwan,s high-speed train that will connect Taipei and Kaohsiung along the island,s west coast will be delayed one year. Originally scheduled to begin service on October 31, 2005, Ing indicated that the train will not begin operations until October 31, 2006.

3. (U) Media reports blamed the delay on slow construction of the core electrical machinery (EM) system. As of late August 2005, THSRC reports that work on civil engineering components (noise barriers, tunnels, etc.) and on the track itself is nearing final completion. Construction of the passenger stations is not far behind, estimated at 92 percent complete. However, only 60.4 percent of the EM system is complete at this time.

4. (U) A consortium of Japanese firms, Taiwan Shinkansen Corporation (TSC), is the contractor for the EM system. TSC includes Mitsui Corp., Mitsubishi Heavy Industries, Mitsubishi Corp., Marubeni Corp., Sumitomo Corp., Kawasaki Heavy Industries and Toshiba Electric. Some reports have blamed Mitsubishi Heavy Industry for the delay to the EM systems due to difficulties meeting quality specifications for the signal and communication systems.

5. (C) A contact associated with one of the TSC consortium member firms told AIT econoff that the major problems lay mostly in the signal systems. He indicated that Mitsubishi Heavy Industry had reorganized the section working on those systems as a result of the delays. He speculated that even the revised schedule may be difficult to meet and that although the high-speed rail might be able to offer limited service by the new deadline, full service may not be up and running until as late as mid-2007.

6. (U) According to media reports, TSC proposed a new schedule to THSRC with new conditions, including higher compensation, no penalty for construction delay, new payment conditions and a three-month grace period for completion of construction. TSC Chairman Sato Kazuo told the press that the two parties have different interpretations of their obligations under the contract. So far, the two parties have only agreed on the new inauguration date. THSRC Vice President Chian Chin-shan told the press that two

sides would discuss compensation issues after construction is completed and the systems are turned over to THSRC. In her statement, THSRC,s Ing emphasized the partnership between THSRC and TSC and priority placed on finishing the project.

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#### Costs Rise, More Scrambling for Financing

17. (U) THSRC President George Liu told reporters that that the delay would increase construction costs by NTD 19.3 billion (about USD 590 million). This includes additional interest charges of NTD 13.8 billion and operational expenses of NTD 5.5 billion. The total cost of the project will rise from NTD 460.7 billion to NTD 480 billion (nearly USD 15 billion). More importantly, the one year delay significantly reduces the earnings potential of the 35-year build-operate-transfer project by cutting THSRC,s time to operate the railway. Media reports have estimated the lost revenue to be as high as NT\$ 50 billion (about USD 1.5 billion).

18. (U) The delay and associated costs will further exacerbate THSRC,s difficulty in financing the project. THSRC has revised its financing arrangements with its creditors more than a dozen times since the project began. It has renegotiated the financing three times since March. Most recently, THSRC failed to meet its target of raising NT\$ 5.5 billion (about USD 170 million) by July 29. As a result, Chiao Tung Bank, the lead bank of the consortium providing loans to THSRC, has imposed a contract violation penalty of an additional 0.005 percent interest on the firm,s debt. THSRC and the banking consortium have yet to agree on a new financing plan.

#### Will Government Pick Up the Pieces?

19. (U) According to media reports, THSRC,s Ing met with Taiwan Premier Frank Hsieh before the announcement to seek the government,s support for the decision to delay. Hsieh reluctantly accepted THSRC,s new timetable but indicated that the schedule could only be changed once. He promised Ing that the government would continue to coordinate with private entities, such as potential creditors and investors, in support of rail project. Hsieh also reiterated the government,s unwillingness to buy back the project as required by the BOT contract if THSRC fails to complete construction.

110. (U) THSRC also informed the Ministry of Transportation and Communications (MOTC) of the new project timetable. MOTC Minister Lin lin-san confirmed to the press that THSRC,s time to operate the high-speed rail under the BOT contract would not be extended. He emphasized MOTC,s primary concern is the quality of construction, and ensured that MOTC would take action to guarantee the level of quality if necessary.

#### Comment - More Bad News for THSRC Likely

11. (C) Rumors that the high-speed rail would not open on time have circulated for months. THSRC executives have repeatedly denied them, but the announced delay comes as no surprise. Further delays are not out of the question. In addition, the inauguration postponement will only ensure continuing financial problems. News that THSRC has failed to meet it latest finance targets has become routine. The need for more drastic measures to assist the project seems more and more likely. The Taiwan government may still be able to avoid buying back the project or investing its own resources, but it will probably have to take an active role in arranging for some other white knight to save the high-speed rail.

112. (C) This news could hardly come at a worse time for the Taiwan government. Whether the government should have, or even could have, exerted more control over the project is a topic of fierce debate, dividing along predictably partisan lines. However, coming less than three months before island-wide elections and in the wake of labor and safety problems with the

construction of the Kaohsiung subway and prolonged water shortages following recent typhoons, the Pan-Blue will seize this announcement as further proof of the DPP,s inability to govern.

KEEGAN